No. 429

SEP 29 1942
CHARLES ELMORE CROPLEY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

HURLBUT W. SMITH,
Petitioner and Appellee below,

vs.

FRANK J. SHAUGHNESSY, Collector of Internal Revenue of the United States for the Twenty-first District of New York,
Respondent and Appellant below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered on July 6, 1942, reversing the judgment of the District Court of the United States for the Northern District of New York entered September 10, 1941, and respectfully shows as follows:

OPINIONS BELOW

The opinion of the District Judge upon the trial of the case is printed at page 36 of the Record, and is reported in 40 Fed. Sup. 19. The Circuit Court of Appeals handed down a memorandum decision printed at page 57 of the Record, and reported in 42-2 U. S. T. C., Par. 10, 194.

JURISDICTION

The jurisdiction of this Court to review this decision is derived from Section 240 of the Judicial Code as amended (28 U. S. C. A., Sec. 347), wherein this Court is authorized upon the petition of any party to require by certiorari either before or after a judgment or decree by such lower Court, that the cause be certified to the Supreme Court for determination by it, with the same power and authority and with like effect as if the cause had been brought by unrestricted writ of error or appeal.

This case involves the interpretation of Sections 501 and 510 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

The decision which petitioner seeks to have reviewed was handed down by the Circuit Court of Appeals for the Second Circuit on June 19, 1942.

STATEMENT OF MATTER INVOLVED

This action was instituted in the United States District Court for the Northern District of New York by Huribut W. Smith, petitioner herein, against the defendant, to recover for gift taxes alleged to have been illegally and erroneously assessed against and exacted from petitioner. The taxes were assessed and paid, in the sum of $71,674.22, upon the entire corpus of a trust fund created under a Trust Indenture dated February 26, 1937, whereby the petitioner transferred certain shares of stock to The Syracuse Trust Company, as Trustee, and directed the distribution of the principal and income thereof as follows:

"To pay over the net income from said trust fund quarterly to and for the use of Gladys D. Smith, wife of the Settlor (hereinafter sometimes called the 'Life Beneficiary'), during her natural life, and upon her death to pay over the principal of said trust fund to the Settlor, Hurlbut W. Smith, if he is then living, or in the event of the death of said Settlor prior to the death of the Life Beneficiary to pay over said principal of said trust fund as follows:

The Trustee shall upon the death of said Life Beneficiary pay over the principal of said trust to such person or persons and in such amounts and proportions as the said Life Beneficiary may by her last will and testament direct, and in the event of her failure to make testamentary disposition thereof, then and in that event the principal of the trust herein created for her life shall be paid over and delivered by the Trustee to such person or persons and in such amounts and proportions as would take the same under the laws of the State of New York in case the principal of said trust fund had been owned outright by the said Life Beneficiary and she had died intestate."

A certified copy of the entire record of the case in the Circuit Court of Appeals is hereby furnished as a part of this application in conformity with Rule 38 of this Court relative to cases from the Circuit Court of Appeals.

The case was tried by the Court without a jury and findings of fact and conclusions of law made by the Court whereby it was held in effect that the only taxable gift under the Trust Indenture was the value of the life interest of Gladys D. Smith, the wife of petitioner, and that the plaintiff was entitled to recover from the defendant the sum of $40,109.19 with interest,

being the amount of the tax paid by him less the amount of tax computed upon said life interest of Gladys D. Smith (R. 45, 46).

Judgment was granted for plaintiff for the said sum and entered in said action on September 10, 1941 (R. 47).

The defendant appealed from said judgment to the Circuit Court of Appeals, Second Circuit, by a notice of appeal dated December 9, 1941 (R. 51).

The principal questions raised on such appeal to the Circuit Court were (a) as to whether the District Court erred in holding that the value of the life interest of the wife under the Trust Indenture was the only interest created by said Indenture which was subject to gift tax, and (b) whether the District Court erred in not holding that the entire corpus of the trust fund, less only the value of donor's reversionary interest therein, was subject to gift tax (R. 52, 53).

The Circuit Court of Appeals reversed the decision of the lower Court on the authority of *Herzog vs. Commissioner*, 116 Fed. 2d, 591 (C. C. A. 2).

THE QUESTION PRESENTED

Whether there was a completed gift of the corpus or principal of the trust fund created by the Trust Indenture hereinabove quoted, which rendered the principal subject to gift tax. It was conceded and stipulated that the gift of the life estate was complete and absolute, and was subject to gift tax.

STATUTES AND REGULATIONS INVOLVED

The pertinent Statutes and Regulations are printed in the Appendix, *infra*.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that a gift tax was payable upon all, or upon any part, of the corpus of the trust fund, for the following reasons:

(1) Because the Trust Indenture expressly provided that the principal should revert to the donor, if living at the death of the Life Beneficiary.

(2) Because the possible interests of the remaindermen (statutory distributees of the life tenant) are indeterminate, and are not capable of evaluation, either by deducting the value of the life estate and the reversionary interest of the taxpayer, computed on an actuarial basis, or by any other method. The general power of appointment of the principal precedes and is destructive of any measurable interest of said remaindermen.

(3) Because under the general power of appointment granted by the donor, the principal of the trust may be appointed by the life tenant to any alienee whatever, including tax-exempt charitable institutions.

REASONS RELIED ON FOR THE WRIT

1. The decision of the Circuit Court of Appeals for the Second Circuit, reversing the decision of the District Court, appears to be contrary to the applicable decisions of this Court, particularly in the Hallock and Sanford cases cited below.

It appears on the face of the Trust Indenture that the gift of the corpus of the trust fund was incomplete (and therefore not subject to gift tax), because the donor reserved the corpus to himself if he should survive the life beneficiary. The corpus of the trust fund is clearly subject to estate tax.

Helvering vs. *Hallock*, 309 U. S. 106.

Klein vs. *United States*, 283 U. S. 231.

Burnet vs. *Guggenheim*, 288 U. S. 280.

Ezequiu vs. *Humphreys*, 308 U. S. 54.

Helvering vs. *Hutchins*, 312 U. S. 393, 396.

Burdick vs. *Commissioner* (C. C. A. 2) 117 Fed. 2d, 972, Certiorari denied, Oct. 13, 1941.

In *Commissioner* vs. *Marshall*, 125 Fed. 2d, 843, the Court below held that where a gift was made in trust for a life beneficiary, the principal to revert to the donor if he survived the life tenant, otherwise with remainder over, the entire principal of the trust fund was subject to gift tax. Said decision appears to conflict with the decision of this Court in the *Hallock* case. In both cases the question was, did the donor completely part with the principal. The gift tax is predicated upon something *completely given up* to donees. The estate tax is predicated upon something *retained*. As held in the *Hallock* case, the donor may not be said to have parted with the principal until the event had occurred which determined whether the principal came back to the donor or passed to the remaindermen.

Furthermore, because the gift of the principal was incomplete, it will be subject to estate tax on the death of the donor, whether before or after the death of the life beneficiary.

Helvering vs. *Hallock*, 309 U. S. 106.

Burdick vs. *Commissioner* (C. C. A. 2) 117 Fed 2nd, 972, Certiorari denied Oct. 13, 1941.

The gift tax statute and the estate tax statute are in pari materia, and are supplementary in character. It is submitted

that the supplementary character of the gift and estate tax statutes was established by the decision in *Estate of Sanford* vs. *Commissioner*, 308 U. S. 39, as a general principle, subject only to certain necessary exceptions, and was not intended by that decision to be limited solely to the specific facts of the *Sanford* case, as held by the Court below in *Commissioner* vs. *Marshall*, 125 Fed. 2d, 948. The present case does not fall within the necessary exceptions to the general rule established in the *Sanford* case, and therefore, as the corpus of the trust fund, by reason of the provisions of the Trust Indenture, will be subject to estate tax on the death of the donor, it is not subject also to a gift tax under the same provisions. The very nature of the two taxes seems to preclude the imposition of both, under such circumstances.

The case of *Herzog* vs. *Commissioner* (116 Fed. 2d, 591), on the authority of which the Court below rendered its decision herein, is clearly distinguishable from the present case. In that case the donor had parted with all legal and equitable rights in both principal and income. Anything which the trustee might give him back was wholly discretionary. In the present case, no discretionary power is interposed between the donor and the corpus of the trust fund. If the donor survived the life beneficiary, it reverted to the donor automatically.

The decision of the Court below herein appears therefore to conflict with the decisions of this Court in the *Hallock* and *Sanford* cases.

2. The Circuit Court of Appeals for the Second Circuit has herein decided an important question of federal law which has not been decided by this Court unless to the contrary, and which should be finally settled beyond question by this Court.

This question involves the interpretation of the gift tax statute, as affected by Section 510, which provides as follows:

> "The tax imposed by this title shall be a lien upon all gifts made during the calendar year, for 10 years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift * * *."

The donor herein did not give the principal of the trust fund to *determinable remaindermen*, subject merely to the reversion of the principal to himself if he survives the life tenant. He provided that the principal of the trust should pass, first to the appointees of the life tenant under a general power of appointment by will, and second, and only in case of the failure of such appointment, to the distributees of the life tenant under the New York statute of distribution.

Under said general power granted by the donor, the life tenant may appoint the principal of the trust fund to *any alienee whatsoever, including tax-exempt educational and charitable institutions*, without any limitation, and according to her mere whim or fancy, and thus cut off and destroy the interests of her statutory distributees, as remaindermen.

Farmers Loan and T. Co. vs. Shaw, 127 App. Div. 656, 660; Affmg. 56 Misc. 201.

Matter of McDonagh, 18 Ont. W. N. (Ontario Weekly Notes) 154.

Cutting vs. Cutting, 86 N. Y. 522, 530-531.

Dana vs. Murray, 122 N. Y. 604, 612.

Matter of Moehring, 154 N. Y. 423, 427.

New York Real Property Law, Sec. 134 (Also applicable to personal property, *Matter of Moehring*, 154 N. Y. 423, 427).

The federal authorities are to the same effect.

Morgan vs. Commissioner, 309 U. S. 78.

Treasury Regulations 80 (1937 Ed.) Art. 24.

It thus appears that the potential interests of the distributees of the life beneficiary, as presumptive remaindermen, are wholly dependent upon the mere whim or fancy of a human being, and even further, that the principal of the trust fund may pass, under the general power granted by the donor, to tax-exempt educational or charitable institutions. The potential interests of these remaindermen are therefore impossible of measurement, and have no value which is ascertainable by any known actuarial methods.

Humes vs. United States, 276 U. S. 487.

Ithaca Trust Co. vs. United States, 279 U. S. 151.

Helvering vs. Blair (C. C. A. 2) 121 Fed. 2d, 945, 947-948.

Commissioner vs. Marshall (C. C. A. 2) 125 Fed. 2d, 943, 946-947.

Under the provisions of Section 510 of the gift tax statute, it is axiomatic that a taxable gift *inter vivos* must be a complete bilateral transaction involving a transfer to a determinable donee. It seems impossible to believe that Congress intended to impose a gift tax and impress liability therefor upon the presumptive donee where the interest of such donee is wholly dependent, as a condition precedent, upon the mere whim or

fancy of a human being. *Porter vs. Commissioner* (C. C. A. 2) 60 Fed. 2nd, 673, 674; Affm'd 289 U. S. 436. As stated in cases above cited:

> "A gift is a bilateral transaction and demands a donee as well as a donor; it is incomplete though the donor has parted with his interest, if the donee remains indeterminate, and the beneficiaries are determined only when the power to change them ends."

Hesslein vs. Hoey (C. C. A. 2) 91 Fed. 2d, 954, 956; Certiorari denied, 302 U. S. 756.

Sanford's Estate vs. Commissioner, 308 U. S. 39, 46.

Helvering vs. Blair (C. C. A. 2) 121 Fed. 2d, 945, 947-948.

The decision of the Court below therefore appears to have decided an important question of law as to the interpretation of the gift tax statute, which should be finally settled beyond question by this Court.

An article on "Taxes on Gifts Subject to Contingencies" by Walter L. Nossaman is scheduled for appearance in the coming October issue of the magazine "Taxes." It contains a critical review of decisions of the Circuit Court for the Second Circuit in the *Marshall* and *Herzog* cases, and also on the present case of *Smith vs. Shaughnessy*, as related to the decision of the Supreme Court in the *Sanford* case. Without quoting from the body of said article, we repeat the conclusion reached therein as follows:

> "The present problem has reached a stage where the need of legislative or judicial solution is urgent. The result of the recent decisions dealing with it is, the pres-

ent writer believes, as impractical as it is unjust. It is to be hoped that the circuits in which the problem has not arisen will apply a more critical and realistic view than that applied in the *Marshall* case. The way would then be opened—perhaps it is open now—for a hearing in the Supreme Court which would finally resolve the issue. It seems improbable in the extreme that the court which decided *Sanford's Estate v. Commissioner* would follow the rule laid down in *Commissioner v. Marshall*, or *Smith v. Shaughnessy*."

In the July, 1942, issue of "Estate Conservation," a publication prepared and edited by the Alexander Publishing Company, appears an article entitled "Retaining an Interest in Trust Property—Double Taxation," from which we quote the following:

> "One of the most confused questions in the tax law may be illustrated by these simple facts: John Doe creates a trust the income from which is to be paid to his wife, Mary Doe, for life and upon her death the trust property is to be distributed to his two children, James Doe and John Doe. In the event, however, the children predecease his wife, the property is to be returned to him, if living.
>
> Is the transfer of the property to such a trust subject to a gift tax, to an estate tax or both? If both, what property measures each tax?
>
> When a trust is created the first tax problem in point of time is whether the transfer is subject to a gift tax? The answer to this question depends upon whether a completed gift has been made. As was said in a recent decision, 'It might have been logical for Congress in the gift tax provisions to describe with particularity

those factors determinative of the question whether a completed gift has been made. However, as Congress has not done so we must seek an answer in the decisions of the courts.

The United States Supreme Court had said in the *Sanford's* estate that there is nothing in the language of the statute to suggest that Congress intended to tax gifts before the donor had fully parted with his interest in the property given or that the test of completeness of the taxed gift is any different from that to be applied in determining whether the donor has retained such an interest as becomes subject to an estate tax upon its extinguishment by death. The gift tax is supplementary to the estate tax and both are to be construed together. However, the two taxes are not always mutually exclusive. Gifts in contemplation of death, for example, which are complete and taxable when made are also required to be included in the gross estate for purposes of taxation. If the statutes are not mutually exclusive the question naturally arises in what cases do they overlap?

* * * * * * * *

In the meantime the courts have held that where there is a trust with a possibility of reverter that there is a gift tax measured by the property transferred; that there is a gift measured only by the value of the life estate; that there is an estate tax measured by the full value of the property transferred; that there is an estate tax measured by the value of the remainder interest.

Until the Supreme Court has clarified this confusion, taxpayers should file refund claims if full Gift and Estate Taxes have been paid."

CONCLUSION

It is therefore respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit should be granted.

Dated September 21, 1942.

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APPENDIX

Revenue Act of 1932:

SEC. 501. IMPOSITION OF TAX.

(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in Section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or non-resident, of property by gift.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; * * * (Internal Rev. Code, Sec. 1000).

SEC. 510. LIEN FOR TAX.

The tax imposed by this title shall be a lien upon all gifts made during the calendar year, for 10 years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. * * * (Internal Rev. Code, Sec. 1009.)

Treasury Regulations 80 (1937 ed.):

ART. 24 (in part). Ordinarily a general power is one to appoint to any person or persons in the discretion of the donee of the power, or, however limited as to the persons or objects in whose favor the appointment may be made, is exercisable in favor of the donee, his estate or his creditors.

New York Real Property Law. Sec. 184:

SEC. 184. *General Power.* A power is general where it authorizes the transfer or incumbrance of a fee, by either a conveyance or a will of, or a charge on, the property embraced in the power, to any grantee whatever.

New York General Construction Law. Sec. 37 (in part):

SEC. 37. *Person.* The term person includes a corporation and a joint-stock association.